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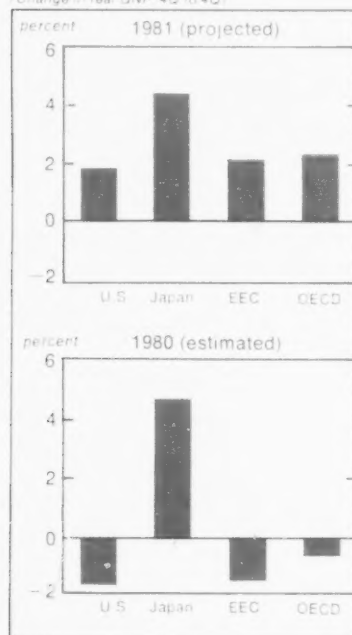
International Finance

Vol. XVI, No. 1
January 5, 1981

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

Projected economic growth in 1981 compared with 1980

(Change in real GNP 4Q to 4Q)



The World Economy in 1981—OPEC Willing, a Weak Recovery

Barring another major jump in the price of oil, the performance of the world economy in 1981 should show considerable improvement over the sorry record of 1980. Although the U.S. and European economies enter the new year on a note of weakness, by mid-summer, at least, the major industrialized nations are likely to be on an upward growth path. The pace of this advance will be relatively slow for the initial stages of recovery from a major world trade cycle, however, and the falloff in the overall rate of inflation will be disappointingly small. Heightened concern with the problems created by increased inflationary expectations has resulted in the adoption of relatively austere monetary policies in many countries. And a huge OPEC surplus will continue to provide a drag on the growth momentum of all oil-importing nations, developed and developing alike.

This projection of sluggish recovery in the industrialized economies and relatively slow economic growth in the oil-importing developing countries assumes an increase in oil prices in 1981 of not much more than 20% above 1980, and nearly half of that increase has already been agreed to at the mid-December OPEC meeting in Bali. Given the uncertainties surrounding the Iraq-Iran war, no projection of oil prices can be offered with very much confidence. If exports from Iraq and Iran do not resume at significant levels in the second half of the year, maintenance of the balance between demand and supply could require even larger price increases. If so, the OPEC surplus would balloon to proportions that would threaten the industrialized economies' recovery from their present recession and dash the hopes of many oil-importing developing countries for continued per-capita income growth in the early 1980s.

Even if the rise in oil prices is held approximately to 20%, the OPEC surplus will remain extremely large this year—about \$110-115 billion, much the same as in 1980. And the distribution of the deficits that are the counterpart to this surplus will weigh even more heavily on the oil-importing developing economies, whose combined current-account deficit will rise another \$8 billion or so to a total of nearly \$60 billion. The total deficit of the OECD countries is likely to fall by a corresponding amount. If even larger price rises and, hence, a larger OPEC surplus are forthcoming, the bulk of the increased deficits would accrue to the industrialized nations, as the limited ability of the oil-importing developing countries to increase their foreign borrowing would force them to cut non-oil imports sharply.

WESTERN EUROPE

The European economies went into a synchronized downturn in mid-1980 and are now in a fairly severe recession. The weakening was induced by oil price hikes since 1979, intensified in many countries by restrictive policy responses. Average real economic growth in Europe last year was some 1.2%, compared with 3.5% in 1979. A consumption-led recovery is expected in the second half of 1981, but the upturn is likely to be both fragile and sluggish and will be insufficient to prevent a decline in 1981 real GDP of an estimated 0.3%, a projection with much downside risk.

Exceptionally restrictive domestic policies led the **British** economy into a deeper and earlier recession than most other European countries. The economy will bottom out in 1981 as inventory liquidation comes to an end and as rising real wages boost consumer demand. Even so, real GDP will fall further this year by perhaps 1½% after a record decline of 2½% in 1980. The recession should, however, reduce the annual inflation rate to some 10% from the May 1980 peak of 21.9% and the current 15.3%.

Official growth projections in **France** are likely to prove optimistic. Real GDP growth last year is estimated at no more than 1.5%. In 1981, a consumer-led recovery will be offset by both weak investment and external demand, reducing the real GDP growth rate to 0.5%. The business slowdown will help lower the average annual rate of inflation from 12.3% last year to 11.2% in 1981. But higher oil prices will trim the current-account deficit only slightly, from 35 billion francs last year to some FF 25 billion.

Switzerland's economy posted real growth of 2.3% in 1980. Real GDP growth this year will be near zero, however, owing to weak external demand. Rising domestic costs will sustain last year's 4% annual average rate of inflation, but the current account—in deficit last year—should be held in rough balance in 1981.

In **West Germany**, a growing current-account deficit and rising U.S. interest rates have put pressure on the German mark and triggered a highly restrictive monetary stance. Consequently, real GDP, estimated to have expanded 1.8% last year, is expected to contract by about 0.6% in 1981. The rate of inflation, which peaked in mid-1980, is likely to fall over the course of 1981, with an average 4.6% rate of price increase expected for the year as a whole. Although recession and increased export competitiveness should cut the non-oil current-account deficit sharply, a higher oil bill will offset much of the gain.

Italy's economy is estimated to have grown by a real 3.3% last year. But the current recession is likely to last through mid-1981 and is expected to bring about a decline in real GDP of some 1.7% this year. Inflation, estimated at over 20% in 1980, is projected to fall to 16%-17% in 1981.

Europe's smaller economies will not escape recession. At best, they are expected to show no growth at all, although the **Scandinavian** countries, whose business cycles usually lag the rest of Europe, should enjoy moderate economic growth in 1981. Oil-blessed **Norway**, for example, may show real growth of some 1.5%. And **Finland** will be increasing its exports to the Soviet Union to pay for Soviet oil imports under the two countries' bilateral trade agreement.

WESTERN HEMISPHERE

Canada's prospects for 1981 are for a 2% real economic growth rate after a slight recession in 1980. Rates of inflation and unemployment, however, will remain above their current 10% and 7.5% respective levels.

Latin American growth this year is expected to decline slightly from the 5% estimated for 1980. The small downturn in the aggregate real GDP growth pace will be attributable mainly to policy-induced demand restraint in **Brazil**. Faced with 100%+ inflation and a current-account deficit of \$13 billion, Brazil is pursuing restrictive fiscal, monetary, and wage measures to reduce growth, inflation, and import demand. In contrast, the **Mexican** economy will grow rapidly in 1981, at a 7.5% projected rate, the same as in 1980. Oil exports are fueling fast growth and aiding the balance of payments, but inflation is approaching the 30% level. **Argentina** should see its economic growth rate revive to about 3% in 1981, after a real GDP decline of 2% last year. Consumer price rises are likely to average 60% in 1981, well below the 100% of 1980.

In the Andean Group, **Venezuela** should post real growth of about 3% as the authorities reintroduce stimulative economic policies after two years of moderation; inflation may drop to 15%

as price decontrol tapers off and import liberalization continues. In **Ecuador**, economic growth should stabilize at about 4.5%, with inflation at 13%, as efforts intensify to develop oil resources. For **Colombia**, development spending will be constrained by inflationary pressures, a 5% real economic growth rate is likely, with a 25% rate of price rise. **Peru** is likely to record real economic growth of about 6% in 1981, but its inflation rate will range between 50% and 60%. In **Chile**, prospects are for 5% real economic growth and a rate of price increase in the 25%-30% range. Although **Paraguay's** economic growth is expected to quicken from the 8% rate recorded in 1980, **Uruguayan** economic activity is likely to slacken from its 4% growth pace of 1980.

The outlook for the majority of Central America is rather bleak. **El Salvador** and **Guatemala** are suffering in varying degrees from grave political upheaval. **Nicaragua** has rescheduled its debt to international commercial banks, but economic revival is blocked by a foreign-exchange scarcity and political uncertainty. And **Costa Rican** and **Honduran** authorities will have to slow their economies to contain external-payments disequilibria. **Panama** is the exception, with real economic growth of 5% expected in 1981, thanks to investment spending and earnings from services industries.

In the Caribbean, the pace of economic growth will quicken in **Trinidad** and **Tobago**, the **Bahamas**, and **Barbados**. The rest of the region will continue hindered by balance-of-payments disequilibria. Most notably, **Jamaica's** international reserves are negligible and its external debt totals \$1.8 billion. The **Dominican Republic** should see some relief in 1981 from its present untenable external-payments position in light of strong sugar prices and normalization of output levels. **Puerto Rico's** economy will be hurt by the lagged effects of the U.S. downturn, but a recession should be averted because of contra-cyclical public policies.

ASIA-OCEANIA

Japan enters 1981 with moderate optimism, a tribute to its ability to withstand repeated oil price shocks. Real economic growth of about 5% is expected. Continued weakness in consumer spending, housing construction, and capital investment point to slow growth in the first half. But, barring unexpectedly large increases in labor and import costs, year-over-year inflation is expected to fall to some 5% by June. Consumer spending is then likely to accelerate, which should stimulate the economy in the second half. Despite an expected appreciation of the yen and renewed fears of protectionism, export price rises, combined with energy conservation measures and a second-half pick-up in the world economy, should bring about overall current-account balance this year, with a moderate deficit in the first half being offset by a small surplus for the July-December period.

In **South Korea**, positive real economic growth is expected this year, perhaps 4%-5%. Inflation will be high in the first half but may moderate toward yearend. Economic growth is slowing in **Hong Kong** and will not be much over 7% this year, owing to the OECD recession, but inflation should fall slightly from the current 15%. **Singapore's** role as an oil-industry service center ensures it strong economic growth in 1981. The 1979/80 oil price rise slowed **Taiwan's** inflation-adjusted economic growth rate to around 6% last year, and contributed to inflation of about 15% and a small current-account deficit. The economy is likely to show only slight improvement in 1981, unless OECD markets recover rapidly.

A real economic growth rate of 5%, inflation of 20%, and a current-account deficit of more than \$2 billion are forecast for **Thailand** in 1981. The **Philippines** economy is not likely to improve much this year, as the prices of its main exports are declining. **Malaysian** real economic growth is projected at around 8%, with an inflation rate below 10%. The current account is likely to show a small surplus because of modest oil exports and continued strength of plantation export crops. **Indonesia's** economic growth should be on the order of 7%, with inflation forecast at 15%-20% and a current-account surplus of \$2½-3 billion. And in **China**, continuing investment restrictions (part of a "readjustment" strategy), lower crop production during 1980, and slower growth in major export markets will restrain real economic expansion to 4%-5% in 1981 and boost the trade deficit over \$2 billion.

Real economic growth of approximately 3% is forecast for **Australia** this year, but inflation is likely to remain near 10%. And **New Zealand's** inflation rate may slow to 14%-15%, with real economic growth remaining sluggish at 1%-1.5%.

MIDDLE EAST- AFRICA

Sharply higher oil prices widened the OPEC current-account surplus to between \$110 billion and \$115 billion in 1980. Prior to the outbreak of the Iraq-Iran war, a \$25-30 billion narrowing in the surplus appeared likely for 1981. But the conflict could result in higher-than-previously-anticipated oil prices, and the 1981 OPEC surplus may not be much smaller than last year.

Saudi Arabia will account for a large share of this year's surplus, despite a high level of spending on military and civilian projects. And a limited absorptive capacity will expand Kuwait's current-account surplus sharply. Increased oil revenues and private-sector activity will accelerate economic growth in the UAE and Qatar, while Oman will be buoyed by a 25% jump in oil output. Egypt's trade deficit should widen in 1981 despite increased oil receipts, but the shortfall will be far more than offset by growing workers' remittances, Suez Canal revenue, earnings from tourism, and a pick-up in the disbursement of foreign aid. The Tunisian economy will grow rapidly this year, thanks to higher oil and phosphate prices, and Morocco's economy will be buoyed by phosphate export earnings and the availability of a three-year \$1.1-billion IMF facility. If war persists, Iran's economy will be on its knees by summer without financial aid, while Iraq's economy boomed in 1980 and is likely to do so in 1981, despite reconstruction costs. Jordan's sound economy has been bolstered by Iraqi financial support, but Syria is unlikely to sustain its high-trend growth rate. And Israeli policy is expected to stay deflationary in 1981, which may improve the medium-term inflation outlook.

Oil exploration and output rose sharply in several Sub-Saharan African countries last year, while prices for many traditional exports declined. Oil-rich Nigeria recorded a \$4.75-billion current-account surplus; it should post only a moderately lower surplus in 1981. Gabon and Angola, the only other African oil exporters, average sales of some 165,000 bpd; they could see current-account surpluses of \$600-700 million in 1981. Cameroon will become a net oil exporter this year and should be able to reverse the recent deterioration in its current account. The Ivory Coast may export oil by 1983, but its 1981 current-account gap is likely to widen from last year's \$1.5 billion if coffee and cocoa price weakness continues. Zaire's output of 20,000 bpd is providing some relief from rising oil costs, as is Ghana's 10,000 bpd. Oil finds in the Sudan, where several minor wells have been brought on stream, brighten an otherwise gloomy economic outlook, and exploration continues in several West African countries. South Africa, lacking oil, has made great headway in producing oil from coal; it may reduce import dependency to 12% of energy needs by 1983.

COMMODITIES

The outlook for world commodity prices this year is clouded by the Iran-Iraq conflict, as the strength of commodity demand, as well as rises in production costs, hinges largely on the path of oil prices. With sluggish growth in the industrialized nations, little improvement is likely for the already weak industrial commodity markets. But consumption of most agricultural commodities is expected to expand. And with world stocks trimmed by poor harvests last year, prices in many of these markets look set to rise.

Sales by the USSR could prompt temporary dips in the price of gold this year, but the primary longer-term influence on price will remain perceptions of progress in fighting inflation. Industrial demand for silver has declined substantially. This, combined with stepped up production, should sustain downward pressure on prices. And platinum demand is likely to remain soft because of the recession in the U.S. auto industry.

The slump in U.S. auto output is affecting the base metals as well. Slack demand for auto batteries is likely to keep lead prices low this year. Copper demand and prices remain weak but may recover if interest rates ease and spur some stock replenishing. Tin prices continue weak, increasing the likelihood of some price-support action by the International Tin Council, while a developing shortage of zinc concentrate could lend volatility to prices. High energy prices and weak cyclical demand have prompted some cutbacks in aluminum output; this could raise prices later in the year if shortages develop.

Two consecutive years of bad harvests in the Soviet Union combined with a serious drought in the United States have left many of the world's agricultural markets in their tightest supply situation in five years. Bumper crops of both wheat and rice, however, are expected in the 1980/81 harvest year. But with record consumption forecast, demand is likely to exceed the current year's output by a wide margin. Feedgrain supplies will be even tighter and high prices may force some adjustment in livestock production plans. Pork and poultry prices in 1981 will be significantly higher, on average, than in 1980. The outlook for beef prices is less clear. Most countries' cattle herds are being rebuilt; their marketing dates will depend on prevailing prices, feed costs, and general economic conditions.

Sugar prices appear likely to rise at least through midyear. Further drawdowns in world stocks are expected, despite the likelihood of small output increases in the current crop year. Large surpluses should sustain downward pressure on coffee and cocoa prices this year.

Tight supplies are expected to keep cotton prices firm in 1981, despite some sluggishness in world textile activity. And rubber demand could be bolstered if U.S. defense spending increases.

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1979		BALANCE OF PAYMENTS						MONEY AND BANKING						COUNTRIES	
		6 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves (less gold) in million \$	12-month change	months of imports covered	use of IMF credit, mil- lions of dollars	current influences on payments	latest data	12-month changes consumer prices	latest data	money supply(M1)	exchange rate in U.S. dollars December 29, 1980	change from year earlier		current monetary conditions
Argentina	Industrial constraints limit economic growth; whole- sale inflation rate down to 60% annually.	May	+ 9%	102.1	\$3,825	Aug.	9,458	+ 17%	13.3	0	Change in currency devaluation system boosts import costs.	Nov.	+ 89%	Aug.	+ 113%	.00051	- 19%	Central bank funnels more funds to banks.	Argentina
Bahamas	Government fiscal budget posted a surplus in 1980.	June	+ 15%	1.1	4,590	Oct.	99	+ 11%	25.0	0	Net capital inflows declined in second quarter of 1980.	June	+ 11%	June	+ 10%	1.0100	+ 1%	Bank liquidity pressured by strong credit demands.	Bahamas
Brazil	Real GDP growth rate neared 8% in 1980, but slow- down is planned for 1981.	Oct.	+ 31%	204.7	1,725	Aug.	5,847	- 40%	2.8	0	Reserves drawn down by \$3.5 billion for external payments.	Nov.	+ 113%	Oct.	+ 55%	.01605	- 35%	Interest rates exceed 100% per annum.	Brazil
Chile	Major copper mining venture scrapped, casting doubt on goal of 50% output rise in 1980s.	Aug.	+ 24%	19.0	1,710	Oct.	2,930	+ 64%	6.1	128	Foreign-exchange controls liberalized; re- strictions on foreign loans eased.	Oct.	+ 31%	June	+ 65%	.0260	0	Net foreign assets rising.	Chile
Colombia	Large capital expenditures planned or under way for electricity, steel, and coal.	Sept.	+ 24%	28.7	1,100	Oct.	4,672	+ 36%	11.0	0	Non-coffee exports represent over 50% of total.	Nov.	+ 26%	May	+ 28%	.0200	- 12%	Peso loan availability is limited.	Colombia
Costa Rica	Tighter demand-management policies being imple- mented to ease import growth.	Aug.	+ 12%	3.9	1,790	Sept.	123	- 14%	1.1	57	Free market for foreign exchange ex- panded to include banking system.	Aug.	+ 19%	Aug.	+ 7%	.1200	0	Interest rates increased.	Costa Rica
Dominican Rep.	Export promotion law passed last year finally im- plemented.	Aug.	+ 19%	5.3	1,000	Oct.	178	- 7%	1.2	58	Normalization of sugar output and high prices will bolster 1981 payments.	June	+ 20%	July	+ 25%	Par	-	Liquidity is tight.	Dominican Rep.
Ecuador	Higher oil export earnings help offset lower output of certain farm crops.	Oct.	+ 12%	8.6	1,064	Aug.	935	+ 59%	4.9	0	Foreign investment on the rise.	Sept.	+ 14%	Oct.	+ 23%	.0380	- 5%	Credit demand shows seasonal increase.	Ecuador
Guatemala	Credit restrictions eased to stimulate the economy.	Dec. '79	+ 9%	6.9	975	Oct.	465	- 30%	3.7	0	Capital flight continues, with October reserves at \$465 million.	Sept.	+ 10%	Aug.	+ 14%	Par	-	Bank reserve requirements low- ered.	Guatemala
Honduras	Economic slowdown anticipated as authorities seek to stem balance-of-payments deterioration.	June	+ 9%	2.2	608	Aug.	169	0	2.0	21	Restrictions on exchange of C. American currencies to curb capital flight.	July	+ 21%	Aug.	+ 8%	.5005	0	Restrictive credit policy in place.	Honduras
Jamaica	Severe foreign-exchange crunch hindering economic activity.	June	+ 38%	2.7	1,250	Sept.	130	+ 19%	1.6	336	Talks with IMF resume; \$570 mn. may be obtained over next 3 years.	May	+ 26%	July	+ 41%	.5700	+ 2%	Credit availability is limited.	Jamaica
Mexico	Economic growth rapid, despite capacity strains, shortages, and high inflation.	July	+ 83%	119.9	1,728	June	2,464	+ 27%	1.5	0	External debt exceeds \$40 billion.	Sept.	+ 29%	Apr.	+ 26%	.0440	0	Demand for peso credit is strong.	Mexico
Panama	Economy expanding at a 5% pace, with construc- tion spending up sharply.	Aug.	+ 22%	2.7	1,420	Sept.	109	- 22%	0.9	29	Colon Free Zone tonnage up 20% over 1979.	Aug.	+ 14%	June	+ 23%	Par	-	Credit is ample.	Panama
Paraguay	Inflation rate running below last year's level, owing to restrictive fiscal and monetary policies.	Aug.	- 16%	3.7	1,225	Oct.	743	+ 24%	15.6	0	Capital inflows are heavy.	Aug.	+ 18%	June	+ 16%	.00795	0	Local lending capabilities lim- ited.	Paraguay
Peru	Tax incentives provided for industrial reinvestment; registration process streamlined.	June	+ 44%	13.0	752	July	1,845	+ 203%	10.3	545	Imports surge in response to liberaliza- tion measures.	May	+ 53%	May	+ 88%	.0035	- 13%	Interest rate increases ex- pected.	Peru
Puerto Rico	Delayed impact of U.S. recession causing slowdown in economic activity and employment.	Aug.	+ 3%	10.2	2,925	Aug.	8,405*	+ 9%	11.0	0	Tourism arrivals in 1980 were below those in 1979.	Sept.	+ 11%	Aug.	+ 2%	Par	-	Commercial loans increase moderately.	Puerto Rico
Uruguay	August inflation rate was 60%, down from 83% at end-1979, with further declines likely.	June	+ 16%	6.9	2,372	Aug.	499	+ 72%	3.8	0	Jan.-June exports up 16% from year earlier, but imports were up 95%.	Aug.	+ 60%	May	+ 27%	.1090	- 8%	Interest rates rise on dollar accounts.	Uruguay
Venezuela	Foreign firms may set up with 85% foreign capital, subject to 51% local ownership after 15 yrs.	June	+ 48%	48.9	3,619	Oct.	6,698	+ 20%	7.2	0	Wide range of tariffs lowered; many im- port license requirements removed.	Sept.	+ 22%	July	+ 13%	.2330	0	Interest rates increased.	Venezuela

*Commercial bank deposits

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World Interest Rates

market rates of Dec. 29, 1980; bond yields as of Dec. 26, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan																																																																												
Central Bank Discount Rate	13.00 penalty-large banks 16.00	17.28	14.00	12.00	9.50	7.50	16.50 penalty rate 19.50	8.00	3.00	7.25																																																																												
Day-to-Day Money	19.75 Dec. 30	21.00	13.6875	10.80	10.625*	8.00	17.625**	8.875*	0.50**	9.75																																																																												
Treasury Bills 91-day, Middle Rates	14.10	17.15	13.0625	12.75	n. a.	n. a.	15.649** 73-day	no dealing	no market	5.875 2-month																																																																												
Commercial Paper prime, 3-month, asked	15.00 finance paper	17.50 finance paper 15% tax w/h	12.95*	11.60 Certified	11.625* Interbank	no market	no market	no market	no market	not traded																																																																												
Bankers' Acceptances 3-month, asked	16.25	17.50 15% tax w/h	14.1875	11.80 Certified	not traded	9.90	20.80**	no market	4.50**	no market																																																																												
Government Bonds Long-term, new and old issues, average yield	11.78	13.00	13.29*	10.856 20% tax w/h	13.73*	8.76**	16.13**	10.51*	4.69**	8.963																																																																												
Industrial Bonds prime, long-term, new and old issues, average yield	12.90 Aa Industrials	13.50	13.98*	14.24	14.65*	8.97**	16.34**	11.63*	5.875**	7.11																																																																												
Bank Short-Term Rate to Best Borrowers (prime rate)	20.50	18.25	15.00*	13.75	13.85*	11.50	21.00 1/8 quar'tly fee on outstg.	11.00*	6.00**	7.50																																																																												
Bank Time Deposits 3-month	16.50 Cert. of Dep.	16.75	14.625*	12.65	11.625*	10.05	10.75	9.50* large deposits	6.9375** residents only	5.00 20% tax w/h																																																																												
Eurocurrencies 3-month, asked	18.375	no market	15.00	no market	12.00	n. a.	no market	9.50	7.00	no market																																																																												
Exchange Rates—in U.S.\$ rates floating against the \$	—	.8404	2.3700	.031661	.2208	.5122	.001081	.4689	.5648	.004820																																																																												
Forward Exchange Cover 3-month, in percent p.a. D = discount, P = premium	—	1.475 P	3.297 P	5.773 P	5.802 P	8.221 P	1.114 D	8.536 P	10.906 P	8.337 P																																																																												
<table><tr><td>Eurodollar Deposits (London, interbank, bid) Dec. 30</td><td colspan="4">International Arbitrage (3-month, hedged) + in favor of U.S. dollars</td><td colspan="4">Eurobonds (average yield on recent straight debt issues)</td><td>Gold Price</td></tr><tr><td>7-day 19.875</td><td colspan="4">U.S.-U.K. Treasury Bills n.a.</td><td colspan="4">U.S. Dollar Bonds</td><td>13.50</td><td>London</td></tr><tr><td>1-month 18.125</td><td colspan="4">U.S.-Canada Treasury Bills -3.63</td><td colspan="4">7 yrs. and under</td><td>13.125</td><td>afternoon fixing</td></tr><tr><td>3-month 17.5625</td><td colspan="4">U.S.-Canada Finance Co. Paper -3.735</td><td colspan="4">Over 7 yrs.</td><td></td><td></td></tr><tr><td>6-month 16.4375</td><td colspan="4">Eurodollars-U.K. Local Auth. Deposits n.a.</td><td colspan="4">DM Bonds</td><td></td><td></td></tr><tr><td></td><td colspan="4"></td><td colspan="4">7 yrs. and under</td><td>9.00</td><td>593.75</td></tr><tr><td></td><td colspan="4"></td><td colspan="4">Over 7 yrs.</td><td>9.25</td><td>(per fine ounce)</td></tr></table>											Eurodollar Deposits (London, interbank, bid) Dec. 30	International Arbitrage (3-month, hedged) + in favor of U.S. dollars				Eurobonds (average yield on recent straight debt issues)				Gold Price	7-day 19.875	U.S.-U.K. Treasury Bills n.a.				U.S. Dollar Bonds				13.50	London	1-month 18.125	U.S.-Canada Treasury Bills -3.63				7 yrs. and under				13.125	afternoon fixing	3-month 17.5625	U.S.-Canada Finance Co. Paper -3.735				Over 7 yrs.						6-month 16.4375	Eurodollars-U.K. Local Auth. Deposits n.a.				DM Bonds											7 yrs. and under				9.00	593.75						Over 7 yrs.				9.25	(per fine ounce)
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The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
 * Market rates as of Dec. 24; bond yields as of Dec. 19. ** Market rates as of Dec. 17; bond yields as of Dec. 12.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	12.6 (Nov.)	11.2 (Nov.)	15.3 (Nov.)	13.5 (Nov.)	5.5 (Dec.)	21.5 (Nov.)	4.2 (Nov.)	7.8 (Oct.)
Industrial production*	-2.5 (Nov.)	-2.2 (Oct.)	-9.5 (Oct.)	-3.0 (Oct.)	3.2 (Oct.)	2.9 (Oct.)	4.0 (Sept.)	4.8 (Oct.)
Trade balance† (billions of local currency units)	-\$1.86 (Oct.)	C\$0.69 (Oct.)	£0.45 (Nov.)	-FF5.90 (Nov.)	DM0.38 (Nov.)	Lit.2.340 (Oct.)	-SF0.51 (Nov.)	¥117 (Nov.)
Money supply (M₁)*	6.4 (Sept.)	7.9 (Oct.)	4.2 (Sept.)	9.1 (Aug.)	3.5 (Oct.)	17.3 (July)	6.7 (Sept.)	4.3 (Sept.)
Velocity of money (M₁)*	3.4 (June)	10.7 (June)	11.7 (Mar.)	n.a.	5.8 (June)	4.3 (Mar.)	n.a.	5.7 (June)
Reserves minus gold (\$ million, change from previous month)	970 (Oct.)	-253 (Oct.)	-73 (Oct.)	858 (Oct.)	2,553 (Oct.)	419 (Oct.)	2,364 (Oct.)	981 (Oct.)

* Percent change from 12 months earlier

† Figures are only for the month indicated

The U.S. Economic Outlook

Last year was a time of extremes for the U.S. economy. A recession in the first half of the year was one of the sharpest of the past four decades—but it was also the shortest on record. The rate of price inflation was extremely high early in the year, abated for a few months, and then rebounded. Interest rates reached record-high levels, then receded sharply, and then established even higher new records. The unemployment rate rose by about two percentage points, to a peak of 7.8%, and then drifted a bit lower.

For 1980 as a whole, total real Gross National Product was down modestly, by about 0.2%. But some industries suffered substantially. Sales of new automobiles fell by 15%, to about nine million units. On balance, all of the declines came in domestic models; sales of small, fuel-efficient imported cars remained strong. Construction was started on only 1.3 million new housing units—about 25% less than in 1979, which was itself an unsatisfactory year for homebuilding. Industries that supply the automotive and construction industries have thus had extremely weak years.

The new year opens on a note of weakness, as did 1980. Consumer spending leveled off late last year, in real terms, under pressure of rapid inflation and sky-high interest rates. Residential real estate activity began declining again, as a consequence of high interest rates. And with Social Security taxes having risen on January 1, it seems to many experts that another period of economic decline may be at hand. However, most expect it to be both brief and mild. Lower interest rates, a somewhat lower inflation rate, and an expected cut in both individual income taxes and business taxes could bring a broad-based and more sustained advance in economic activity by the beginning of the summer. On balance, average real GNP in 1981 will be up little, if any, from 1980, although a gain of about 1½% is expected on a fourth-quarter to fourth-quarter basis.

Inflation continues to be a deep-seated and persistent problem for the U.S. economy. Some elements in recent rapid price increases, to be sure, may be transitory. The process of decontrolling the prices of domestic crude oil, for example, is giving the United States an even faster advance in the cost of petroleum-based products than that experienced elsewhere in the world. (The decontrol process is to be completed by this October.) And disappointing crops in 1980 have stimulated consumer food prices; these will rise by 15%-20% between mid-1980 and mid-1981. Better crops this year, if they materialize, could bring some relief to food prices later in 1981. In consequence, the rate of price inflation may improve as the year passes. But beneath such special factors, the United States has an underlying inflation rate of 9%-10%, as measured by rising unit labor costs in the face of poor productivity.

The new administration and Congress may well feel that the recent elections give them a mandate to deal more firmly with inflation. Policies to this end will include efforts to reduce the cost of government regulations, tax changes designed to stimulate saving and investment, and, most important of all, attempts to cut back the fast rise in non-defense federal spending and lending programs. Of these policy goals, the most difficult to fulfill will be the reduction in non-defense spending. Many of the programs involved are designed to grow automatically at least as fast as inflation. And the beneficiaries of these programs have by now become accustomed to their benefits. Even if progress is made toward these objectives, however, no significant decline in the inflation rate is likely in 1981. Consumer prices are forecast to rise about 11% from fourth-quarter 1980 to fourth-quarter 1981, compared with 12% from 1979 to 1980.

Lower interest rates likely

Short-term interest rates are expected to fall in the first half of 1981—although not as low as they fell last spring. With stronger money demand as the economy recovers—and assuming the Federal Reserve holds to its money growth targets—rates should move considerably higher after midyear. The federal funds rate, for example, is likely to average 13%-14% for 1981 as a whole, about the same as in 1980.

One of the central elements of the 1980 financial environment was the Federal Reserve's implementation of a policy of placing greater emphasis on achieving money growth objectives and less on stabilizing interest rates. Many observers have attributed to the Federal Reserve a desire to achieve almost complete control over the growth of the monetary aggregates. But so far, the Fed has not intended to do so. Indeed, there are currently a number of operating problems that virtually ensure that it cannot do so.

Despite the caveats, however, the outlook for money growth provides a perspective by which to assess at least the direction, if not the exact magnitude, of interest-rate moves in 1981. This approach may be illustrated by using M1-B as the relevant monetary aggregate. In recent years, the trend growth rate of money turnover (velocity) has approximated 3½%. The Federal Reserve's indicated maximum target for M1-B growth during 1981 is 6%. This suggests that nominal (current-dollar) GNP could advance by as much as 9½% (the product of money growth and turnover) without entailing above-target money growth and the attendant upward pressure on interest rates. This formulation, however, is subject to considerable error from quarter to quarter.

The basic dilemma facing the Federal Reserve and

The U.S. Economic Outlook *(continued from page 7)*

other economic policymakers is that a 6% money growth maximum provides little room for real growth in 1981 as long as the underlying inflation rate is in the 9%-10% range. With a weaker economy in the early part of the year, the money growth constraint should not be binding and interest rates are likely to fall. Nonetheless, during this period nominal GNP will be advancing at an annual rate approximating 8%, and money growth will probably be well within the Fed's target range. Thus, any downward rate correction is expected to be moderate. This contrasts with the second quarter of 1980, when nominal GNP was flat and money growth fell below the Fed's target range, precipitating a sharp rate decline.

A second-half recovery, however, is likely to entail nominal GNP growth well above 10%, on an annual basis. This will place relatively pronounced pressures on the Federal Reserve's money growth targets.

Three additional elements have an important bearing on the money-growth and interest-rate outlook. First, the introduction of new transaction accounts on a nationwide basis (e.g., NOW accounts) will alter the growth path of such narrower aggregates as M1-B. Some redefinition of targets and changes in relative emphasis, such as between M1-B and M2, are thus likely. Second, the level of interest rates relative to inflation will affect the performance of the economy as well as expectations. In the closing months of 1980, interest rates were quite high relative to inflation. This drag on the economy will carry into first-quarter 1981 and probably re-emerge later in the year. Third, the prospect of financing a federal deficit of some \$50 billion casts further doubt on the likelihood of much relief from high interest rates.

Finally, the outlook for business financing in 1981 is for moderate increases in capital expenditures (as well as inventories) and sluggish growth of cash flow. The financing gap for nonfinancial corporations is thus projected to be slightly above that of 1980. Moreover, firms are expected to continue the buildup of short-term liquid assets that began in the third quarter of 1980. The volume of credit-market financing in 1981 is therefore expected to be somewhat above 1980, contributing some pressure on interest rates.

U.S. current-account outlook

Last year was another banner year for U.S. exporters. Following the 28% growth in exports during 1979, 1980 registered a strong increase of slightly less magnitude. Were it not for huge oil price shocks, the U.S. trade deficit would have narrowed dramatically, as the growth rate of non-oil imports was slower than the rate of inflation. But with oil prices for the fourth quarter of 1980 some 33% above fourth-quarter 1979 levels, the overall trade gap was narrowed by only some \$4.5 bil-

lion. This limited improvement, combined with the continued earnings growth in the services account, was sufficient to give the United States its first current-account surplus in four years. The U.S. surplus was all the more notable as it was achieved at the same time that Japan, Germany, and other traditional-surplus countries sustained massive current-account deficits.

The U.S. current account may continue its long climb back to solid surplus this year, the result largely of a renewed U.S. recession. But OPEC pricing policies, the severity (and timing) of economic slowdown in Europe, weak demand for exports by the deficit-ridden non-oil developing nations, the possibility of renewed U.S. import demand, and a leveling-off of the services surplus could exert a strong negative impact in the second half of the year.

Total export growth for 1981 is projected to decline to between 9% and 15%. Agricultural exports are expected to provide momentum, but non-agricultural exports, which advanced sharply in 1980, are expected to lag in 1981. They will be hurt badly by the slowdown in foreign economic activity, which could be further exacerbated by greater oil shocks.

Import prospects continue to be heavily dependent on the uncertain oil price scenario. Total imports are forecast to expand by 14%-15%, largely a result of anticipated oil price rises. U.S. oil import costs in 1981 are projected to exceed \$100 billion, up some 20% from 1980, while nominal non-oil imports are expected to rise by only about 9%—below the forecast inflation rate. The United States will essentially be paying for more expensive energy by curtailing non-oil imports. Although the United States was able to reduce oil imports substantially in 1980, it will be extremely difficult to reduce import volume further this year.

In sum, the U.S. external-account outlook for 1981 is highly uncertain. Reduced levels of real economic growth around the world will dampen trade activity for all trading nations in 1981, dimming prospects for both export and import growth in the United States. Still, the possibility of another large merchandise trade deficit in 1981 means that the United States will again rely on services earnings to bolster its current account. And indeed, earnings from direct investments abroad, as well as receipts from such other services as transportation and insurance, should improve. The pace, however, will be slower this year than in 1980, in view of the expected weakness in foreign economic activity.

With so many imponderables on the horizon, projecting a U.S. current-account balance for 1981 is highly speculative. The current account could range anywhere between a deficit of \$8 billion and a surplus of \$6 billion, much depending on the oil-import outcome. The most likely scenario, however, is for a 1981 U.S. current account in near balance.